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BRANCH BANKING WITH SPECIAL REFERENCE TO CALIFORNIA CONDITIONS

The question of branch banking is becoming of increasing practical importance in the United States. At the 1921 meeting of the American Bankers' Association the question was the subject of debate and resolution. A bill has been before Congress to permit national banks located in states, the laws of which authorize branch banks, to establish branches in the city where the head office is located. An amendment of this character has been supported by the National Bank Division of the American Bankers' Association, the Comptroller of the Currency, and the Federal Reserve Board.

California is developing a system of branch banks more rapidly and extensively than any other state. In April, 1922, Messrs. A. C. Miller and J. R. Mitchell, of the Federal Reserve Board, visited the state to investigate California conditions in order to assist in formulating the Board's policy in regard to state bank members of the Federal Reserve System. A Los Angeles national bank is making an interesting test of the national law, which has always been held to prohibit branch banking, by establishing branches in the home city. These developments center attention upon the California situation.

The purpose of this paper is not primarily to set forth the writer's views upon branch banking but to present the facts concerning the situation at the present time. California conditions are especially examined because of their significance and because of the writer's special opportunity for studying the situation in the state. Branch banking has been tried but a comparatively short time in California so that tentative conclusions only can be drawn from the experience of her banks.

Experience with branch banking.—While branch banking is little practiced in our American states it is characteristic of banking systems in practically all other commercial nations.

Commercial banking in Canada is carried on by seventeen chartered banks consisting of 4,851 branches (as reported in February, 1922). Of these branches 154 are located outside of the Dominion and the remainder are domestic offices. There is no central bank in Canada, nor any institution similar to our own Federal Reserve banks. European systems can best be characterized as made up of a few large banks with branches headed up by a quasi-public central bank. The English system is typical of this class. On December 31, 1920, there were in England twenty joint-stock banks and five private banks. The joint-stock banks had 7,257 branches. The Bank of England has only eleven branches in England and none in foreign countries.¹

Early banking in America also furnished many examples of branch systems. The First Bank of the United States had eight branches and the Second Bank of the United States had twenty-five branches. The state banks of Indiana, Ohio, and Iowa were typical branch systems. The Free Banking System of New York was the chief model for the national system. Control of note issue was accomplished in the Free Banking System by allowing each bank to obtain a separate charter and protect its note issue by the deposit of bonds. Following this model the national law, therefore, provided for unit banks and bond-secured currency. The Federal Reserve Act provided for foreign branches of national banks, under certain limitations, but made no reference to domestic branches. Federal Reserve banks were given authority to establish branches, and twenty-three branches have been established by the twelve reserve banks. The experience with these branches has been entirely satisfactory.

Branches of national banks.—The national banking law makes no provision for branches of the banks created thereunder, but there is nothing in the language of the statute which expressly prohibits national banks from establishing branches. Section 5134 of the Revised Statutes requires the organization certificate to specify among other things: "The place where its operations of discount and deposit are carried on, designating the state,

¹ As reported in the banking number of the *London Economist*, May 21, 1921.

territory, or district, and the particular county, or city, town, or village.”

It is further provided (Sec. 5190) that “The usual business of each national banking association shall be transacted at an office or banking house located in the place specified in its organization certificate.”

The national banking law gives the Comptroller ample power of control and regulation over the general business of the banks. The fact that he is not given any specific power to regulate the establishment and conduct of branches seems clearly to indicate it was not the intention of Congress to authorize the establishment of branches. This view is further supported by the fact that the law has specifically permitted state banks, when converted, to retain their branches (Sec. 5155). The attitude of Congress is further shown by the act of May 12, 1892, providing that any national bank in Chicago, under specific authorization, could conduct a banking office on the exposition grounds. A similar act was passed for St. Louis at the time of the Louisiana Purchase Exposition. The law must ultimately be interpreted by the courts rather than by subsequent acts of Congress, but these sections and amendments indicate rather clearly the attitude of the law-makers.

The construction of the law by the Comptroller has been uniformly that a national bank must transact its usual business in one office. In 1911 the Lowry National Bank of Atlanta, Georgia, requested permission to establish a branch office in the city. An opinion was asked of the Attorney-General by the Treasury Department. J. A. Fowler, assistant to the Attorney-General, wrote the opinion which was approved by Attorney-General George W. Wickersham, denying the right of a national bank to establish a branch for the purpose of carrying on a general banking business.¹ No case appears to have been brought in the courts testing the right of a national bank to establish branches. In his opinion Mr. Fowler cited the case of the Oakland County Bank, which was established by a special act of the legislature of Michigan and later opened a branch in Detroit. There was

¹ *Opinions of the Attorneys General*, XXIX, 81.

no specific prohibition against branches but its action was held to be illegal by the courts.¹ On the other hand the courts have clearly recognized the distinction between a mere agency for the transaction of a particular business, such as the purchase of bills of exchange, and a branch bank for carrying on a general banking business. The power to establish agencies has been sustained by the courts.²

The Solicitor of the Treasury has also held that a national bank may not establish a branch or agency for the purpose of receiving deposits and cashing checks.³

The fact that the law as interpreted has stood in the way of the direct establishment of branches by the national banks has not prevented them from acquiring chains of branch banks indirectly. Three principal methods have been used to bring this about: First, national banks formerly state banks, when converted, have continued to operate branches; second, state banks having branches have been consolidated with national banks; third, an affiliated state bank or trust company is organized and owned by the same stockholders for the purpose of establishing branches.

In his 1921 report the Comptroller lists (p. 107) twelve national banks which fall in the first group—those which had branches when converted from state banks. With one exception these banks all have their branches located within the same city as the parent bank. The exception is the Bank of California, National Association, of San Francisco. This bank has branches at Portland, Seattle, and Tacoma. It is an old institution and in the gold days maintained branches at Virginia City and New York in order to deal in bullion. It subsequently closed these branches and found other means of handling this part of its business. In 1905 the Bank of California, then a state bank, consolidated with the London and San Francisco Bank, an English institution with head office in London and branches in San Francisco, Portland, Seattle, and Tacoma. In February, 1910, the Bank of California

¹ *People v. Oakland County Bank*, 1 Douglass 282, 288.

² *Bank of Augusta v. Earle*, 13 Pet. 519.

³ *Pratt's Digest*, edition 1920, p. 100.

became a national association, bringing with it into the system the three northern branches. This bank has specialized in handling grain exports to European countries and finds these branches essential in handling the accounts of large exporting firms which have their offices in these four exporting cities.

Only five national banks are operating branches as a result of consolidation with state banks.¹ Three of these are large New York banks and these three together with three other New York City banks, converted from state banks, operate an aggregate of forty branches. The existence of those branches is largely responsible for the popular but erroneous idea that national banks have a right to establish branches under certain limitations. It does make it possible for a national bank to operate branches but it does not enable a national bank to establish any additional branches.

No data are available as to the number of national banks indirectly operating branches through affiliated state banks or trust companies. Such cases have not been uncommon in states which accord to state banks the privilege of establishing branches. In California there are several examples of national and state banks under joint ownership where the state institution operates a chain of branches. For instance, the First National Bank of Berkeley controlled a chain of branches in the city through the Berkeley Bank of Savings and Trust Company. The First National Bank of Los Angeles and the Los Angeles Trust and Savings Bank are under one ownership and this institution has been one of the most active in the recent extension of branch banking in California.

In these three ways, therefore, national banks have succeeded in getting around the law which has stood in the way of their establishing branches. Although no figures are available there are probably more branches operated through affiliated state institutions than by either of the other two methods. Where a national bank has succeeded to the business of a state bank with branches, or consolidated with a state bank, the possibility of

¹ Under authority of the consolidation act of November 7, 1918. See *Report of the Comptroller of the Currency, 1921*, pp. 108-9.

further extending its branch system is at an end. Moreover, it may prove very expensive to acquire a state bank for this purpose.

Believing that the national law may fairly be construed to allow a bank to establish branches in its home city, W. A. Bonyng, president of the Commercial National Bank of Los Angeles, has set up several agencies, or branches, in Los Angeles. This action followed a conference which Mr. Bonyng and his attorney held with Comptroller D. R. Crissinger at Washington. The Commercial National Bank now has in operation three of the branches, the establishment of which has been formally approved by the comptroller. Instead of branches these will be known as agencies. But the name means little, for it is the purpose of the officers of the bank to receive deposits, pay checks, and carry on such other banking functions as they deem expedient at these agencies. If the establishment of branches should be held to be illegal the obvious remedy is to convert into a state bank. This the bank's president states he will do rather than give up the right to operate branches. The test of the national law upon this point is attended, therefore, with comparatively little risk to the Los Angeles bank. But the possible consequences of the action are quite far-reaching. If it is lawful for a California national bank to establish branches, it is equally so for national banks in other states, even where state banks are not accorded that privilege. State banks will then feel that they are subjected to unfair competition. Conditions will be just the reverse of those now existing in California and other states where state banks are free to establish branches and national banks are not accorded a like privilege.

The obvious solution appears to be to amend and clarify the national law in the interest of justice and uniformity. National banks located in states which allow state banks to establish branches should be granted the same right. At the last annual meeting of the American Bankers' Association (held at Los Angeles, October, 1921) the National Bank Division adopted a resolution requesting Congress "to so amend the National Bank Act as to permit national banks to maintain and operate branches

within the corporate limits of the cities in which the head offices of such national banks are located, to be confined, however, to states in which state chartered institutions are authorized to have branches.”¹

The writer sees no valid reason why this request of the national bankers should not be granted. In fact it appears that Congress should go farther and allow them the same privileges as are accorded to state banks in the various states. It will be necessary, if California national banks are to be placed on a footing of equality with state banks, to allow national banks to establish branches anywhere within the state.

If this is not done the national system seems bound to suffer a relative decline. The superintendent of banks in California reported that during the fiscal year ended June 30, 1921, nine national banks joined the state system and six state banks converted into national banks. The net gain to the state system in aggregate assets was \$55,511,000.² This tendency has been continuing since that time.³

National banks do not appear to have converted into state banks for the purpose of establishing branches of their own but have come into the state system principally as branches of state banks. For instance, when the Mercantile Trust Company of San Francisco recently acquired the First National Bank of Berkeley, it withdrew from the national system an institution which on September 6, 1921, reported over \$6,000,000 of total resources.⁴ Seven national banks are included in the group to be merged with the Los Angeles Trust and Savings Bank.⁵ These larger state banks are members of the Federal Reserve System. In this way they get practically all the advantages of national organization. Approximately fifty state banks in California are members of the Federal Reserve System.⁶ Twenty-

¹ *Journal of the American Bankers' Association*, November, 1921, p. 405.

² *Report of the Superintendent of Banks, 1921*, pp. 24, 25.

³ *Coast Banker*, April, 1922, p. 388.

⁴ *Report of the Comptroller of the Currency, 1921*, p. 483.

⁵ *Bulletin of the California Bankers' Association*, May, 1922, p. 159.

⁶ *Coast Banker*, March, 1922, p. 290.

five of these with total resources of \$720,544,000 on December 31, 1921, were operating branches. These twenty-five banks represented 46 per cent of the resources of the state system.

Branches of state banks.—Continuous data concerning the laws of the states generally in regard to branch banking are not available. In 1910 Professor George E. Barnett, investigating for the National Monetary Commission, reported that the laws of nine states permitted branches of state banks, eight states specifically prohibited branches, and in the remainder the law was silent. In the majority of states where there was no specific provision for branches they were held to be unlawful.¹

The Federal Reserve Bank of San Francisco has just completed a digest of the laws of the several states relative to branch banking. Data were obtained directly from the other Federal Reserve banks concerning the laws of the states in their district. Through the courtesy of the officers of the Federal Reserve Bank of San Francisco this digest was available to the writer and a summary of it is presented herewith:

SUMMARY OF THE LAWS OF THE SEVERAL STATES
RELATIVE TO BRANCH BANKING

Permitted	Prohibited	No Specific Provision
*Arizona	Alabama	*Arkansas
California	Colorado	District of Columbia
Delaware	Connecticut	Florida
Georgia	Idaho	Illinois
Louisiana	Indiana	Iowa
Maine	Missouri	Kansas
Massachusetts	New Hampshire	†Kentucky
Mississippi	New Jersey	*Maryland
New York	New Mexico	*Michigan
North Carolina	North Dakota	Minnesota
Ohio	Oregon	Montana
†Pennsylvania	South Dakota	Nebraska
Rhode Island	Texas	Nevada
South Carolina	Utah	Oklahoma
Tennessee	Washington	Vermont
Virginia	Wisconsin	West Virginia
Wyoming		

* Branch banking is practiced.

† Power denied by the courts but there is one bank having branches.

‡ Only by special act of the legislature.

¹ *State Banks and Trust Companies since the Passage of the National Bank-Act.* Publications of the National Monetary Commission. Senate Document No. 659, 61st Congress, Second Session.

Classification of states according to whether or not branch banking is permitted is difficult. Exceptions are numerous and the lack of specific provisions in the law places some states in an uncertain position. It will be noted that the laws of sixteen states now prohibit branch banks, seventeen states permit them, and in fifteen states and the District of Columbia there is no specific provision in the law. Of the fifteen states in the laws of which there is no specific reference to branches, four practice branch banking to some extent and the other eleven do not now allow branches of state banks. This increases the total number of states in which branch banking is not tolerated to twenty-seven, and of those in which it is apparently allowed in some form to twenty-one. The laws of some states, for example, New York, Massachusetts, and Ohio, permit branches only in the same city. Branches are now permitted in New York only in cities of 50,000 or more.

In some states where branches are now prohibited, banks are still operating branches established prior to the passage of the present law. Professor R. B. Westerfield shows that state banks in at least twenty-three states were operating branches in 1920.¹ Alabama, New Jersey, Washington, Wisconsin and Indiana, are states having branch banks, according to his compilation, the laws of which now prohibit the establishment of new branches. These states cut off the right of banks to establish branches in the years 1911, 1915, 1919, 1919, and 1921, respectively. A comparison of the 1922 figures with those of Professor Barnett for 1910 shows a gain in the number of states in which branch banking is being practiced.

Banks have sometimes been brought under single control even in states where branches are not permitted. A national bank is prohibited from owning the stock of another bank and the laws of a majority of the states also prohibit state banks from owning the stock of other banks. But it is almost impossible to prevent the ownership of several banks by the same person or group of persons or a holding company formed for this purpose.

¹ *Banking Principles and Practice*, II, 298.

In this way "chains" of banks have been maintained in spite of prohibitory laws.

Branches of state banks in California.—The Bank Act of California provides that branch offices may be established with the written approval of the superintendent of banks. He is directed to give such approval only when "he has ascertained to his satisfaction that the public convenience and advantage will be promoted by the opening of such branch office."¹

When the branch office is to be opened in the city where the principal office of the bank is maintained the bank must have \$25,000 capital for each branch in excess of the minimum requirement for a state bank in that city. For each branch, other than a trust company, outside of the principal place of business the capital must be at least equal to the amount required for an independent bank at the place where each branch is established. In other words, a San Francisco bank which wishes to establish a branch in Berkeley must have a minimum capital of \$300,000 plus \$100,000 for the Berkeley branch, this being the amount required for separate institutions in these cities.

The law further limits the extension of business upon a given capital by fixing a minimum percentage of capital and surplus to deposit liabilities, graduated according to the volume of deposits. In commercial banks the proportion ranges from 10 per cent of deposits up to and including \$2,000,000, to 5 per cent of deposits in excess of \$5,000,000. In savings banks the proportions are graduated down from 10 per cent on deposits of \$1,000,000 or less to 1 per cent on deposits in excess of \$25,000,000.² Since a branch system is treated as a unit this principle of graduation enables a bank having fifty branches to carry on a given volume of business with less capital and surplus than if the system consisted of fifty unit banks.

As a matter of fact there does not appear to be any tendency for the banks to utilize this possibility. An examination of the statements of the larger banks shows that they have capital

¹ Bank Act of California, Section 9.

² *Ibid.*, Section 19.

and surplus far in excess of the minimum requirements. Generally speaking the capital is increased as the number of branches increases. It is true, nevertheless, that many mergers result in a temporary decrease in banking capital, since stockholders of the bank to be absorbed are paid in cash or by stock in the larger bank, which stock the directors have obtained for this purpose by purchase in the market. The combined capital is thus reduced by the amount of the capital of the bank absorbed. This has been done in more than one of the recent consolidations. Another method, used by at least one of the Los Angeles banks, is to exchange unissued stock in the main bank for the stock of the bank to be absorbed. Authorized stock is held in the treasury which may be used for this purpose.

At the present time (May, 1922) there are seventy-nine state banks in California operating 254 branch offices. Of these branches 151 are in cities other than those in which the banking corporations maintain their principal place of business. The remaining 103 branches are in the same city as the head office of the bank.

The general policy of the superintendents has been to sanction the establishment of branches in outside cities only through the acquisition of existing institutions. In the case of branches or agencies in the same city very little restriction has been imposed upon the action of the banks. The purpose of the policy of limiting the extension of banking offices in country towns is to protect the banks and public against the evils of excessive competition. Exception has been made when local conditions seemed to warrant the establishment of another bank.

Metropolitan branch banking.—In discussing branch banking in California different types of development must be recognized. Distinction must be made between what might be called metropolitan branch banking and state-wide or district branch banking.

In the larger cities of the state, chiefly San Francisco and Los Angeles, there has been quite a marked development of what can best be described as metropolitan branch banking. This type of branch system is found in several other cities of the

United States so that California's experience in this respect is not unique. Convenience of patrons is the primary cause of the growth of this type of branch banking. The following list includes the principal banks of this type, but does not include the Bank of Italy and the Los Angeles Trust and Savings Bank, which are also operating numerous metropolitan branches:

LIST OF PRINCIPAL BANKS ENGAGED IN "METROPOLITAN"
BRANCH BANKING WITH NUMBER AND LOCATION OF
BRANCHES, MAY 22, 1922

BANK	HEAD OFFICE	BRANCHES	
		Location	Number
California Bank	Los Angeles	{ Los Angeles	21
		{ Hollywood	3
		{ San Pedro	1
		{ Santa Monica	1
		{ Sawtelle	1
		{ Van Nuys	1
Citizens Trust and Savings . . .	Los Angeles	{ Los Angeles	13
		{ Hollywood	1
Hellman Commercial Trust and Savings	Los Angeles	{ Los Angeles	9
		{ Blythe	1
		{ Redlands	1
		{ Riverside	1
		{ San Pedro	1
Security Trust and Savings . . .	Los Angeles	{ Los Angeles	9
		{ Glendale	1
		{ Hollywood	2
		{ Huntington Beach	1
		{ Long Beach	3
		{ Pasadena	1
		{ South Pasadena	1
		{ San Pedro	1
Anglo-California Trust Com- pany	San Francisco	San Francisco	5
Mercantile Trust Company . . .	San Francisco	{ San Francisco	1
		{ Berkeley	4
San Francisco Savings and Loan Society	San Francisco	San Francisco	3
American Bank	Oakland	{ Oakland	5
		{ Berkeley	1
		{ Modesto	1
Oakland Bank of Savings . . .	Oakland	{ Oakland	8
		{ Berkeley	1

A distinction may even be made between the banks in the foregoing list. Some of them have confined their operations

almost entirely within the corporate limits, others, notably the Security Trust and Savings Bank of Los Angeles and the Mercantile Trust Company of San Francisco, are looking to a wider area of development. There is nothing to prevent any of these banks from extending the field of their operations to a still larger zone or area.

The development of "metropolitan" branch banking has been most notable in Los Angeles. The leadership has been taken by the California Bank which has been developing its branch system for seventeen years. In recent months the extension has been very rapid on the part of several of the banks. Two circumstances appear to make for the popularity of branch offices in Los Angeles. The chief business and financial area of the city is very restricted, the leading stores, offices, and banks being located within a few city blocks. Traffic congestion is so great that it is very difficult for the suburbanite to drive in with his car and get parking space near his bank while he transacts his business. For this reason some of the leading retail establishments have also found it advantageous to decentralize. The second factor is the large area within the city limits.

Many of these branches are at present simply "service stations" and not banks in the full sense. Of the twenty-seven branches of the California Bank, outside of the head office, only three carry on all banking functions. All of them receive deposits and pay checks. It is the loaning function which is restricted to the leading offices. Obviously this is the phase of banking which requires experience and discretion and cannot be safely delegated to a clerk. Even in those branches where loans are not made, however, the borrower may file his application at the agency and have it forwarded to the head office where it will be acted upon the next day. In this way the borrower may save a trip to the downtown office. The note itself and the credit information pertaining to it are filed in these instances at the head office.

The policy of the Security Trust and Savings Bank on the other hand is to give to its branches full banking functions. There are only two of its branches which at present do not have

independent power of making loans. Most of its managers are vice-presidents of the bank. Loans are made by them in the same way as at the head office. As members of the loan committee of the bank they pass upon loan applications which come in to the head office. Loans made at the branches are dealt with in the same manner. Naturally many loans are granted by the loaning officers in the head office and at the branches without first being passed upon by the loan committee. Small loans, loans of unquestioned quality, loans where the borrower's general credit line has already been approved, are all freely made in either place. By this method the loaning policy of the entire system is co-ordinated and the patrons of a branch are dealt with the same as those at the head office.

It is very doubtful if present conditions in Los Angeles warrant the establishment of so many banking institutions. However it is the testimony of officers of the California Bank, which has been longest in the field, that practically every one of its branches is self-supporting and that in the aggregate they are profitable business getters. The present scramble on the part of all of the banks to obtain locations for branch offices confirms this testimony. The superintendent of banks has imposed practically no restrictions upon the extension of branches within the city. While he is of the opinion that the number of banks is unnecessarily large he has not been able to bring about any practicable plan of development along other lines. The result is an "open season" for establishing branch offices. It appears not to be feasible and might prove unlawful for the interested bankers to divide the territory and thus avoid duplication and wasteful competition. The banks which would prefer not to expand their branch system so extensively are confronted with a condition and not a theory. Theoretically the unit bank with a limited number of strategically located branches would be more economical. But the actual condition is that banks pursuing this policy are losing deposits to the bank with conveniently located branches.

Whether or not the "service station" type of branch can continue indefinitely has not been fully demonstrated. It is

the opinion of some bankers that eventually these branches will be forced by competition to add other banking functions until they become full banks. There is no disposition on the part of the banks which are creating this type of branches to resist this tendency if the demand calls for other services. Substantial bank buildings are being built in many cases which indicates the purpose of the founders to make the branches permanent. As the districts in which they are located develop they expect to expand their functions. Certain residential, retail, or factory districts may never need a bank prepared to make loans independently but will prove very profitable locations for carrying on receiving and paying functions.

Branch banking by economic districts.—The Bank of Italy,¹ with head office in San Francisco, is the only bank which has anything approximating a state-wide system. Its network of about sixty branches and affiliated banks covers all the larger cities of the state. The Bank of Italy is the leader in the branch-banking movement in California in number of branches as well as in area covered. Through an auxiliary corporation it also controls the East River National Bank and the Commercial Trust Company of New York.

Any analysis of the causes of this type of branch development cannot ignore the part played by the aggressive policy of the Bank of Italy. This bank was founded in 1904 and on March 10, 1922, reported total resources of \$196,927,012. Data are not available showing the aggregate resources added to the institution through the absorption of existing banks but this has contributed very largely to the growth of its volume of business.

Representative banks covering a more limited economic area are also shown in the map. In extent of area covered the Los Angeles Trust and Savings Bank ranks next to the Bank of Italy. This bank is affiliated with the First National Bank of Los Angeles, through joint ownership of stock. The two Los Angeles institutions are not housed in the same building but carry on their banking functions in the city separately. The

¹ The Bank of Italy is not a foreign-owned corporation but its president, A. P. Giannini, and many of its officers are of Italian extraction.

Los Angeles Trust and Savings Bank has been authorized to operate approximately thirty-five branch offices in the metropolitan district, some of which have not yet opened for business. The two Los Angeles banks have also affiliated with themselves during the past two years sixteen banks which formerly operated as independent institutions.¹ These banks are all located in southern California (see map p. 510), the most remote from the head office being at Fresno, approximately 275 miles from Los Angeles.

It is the policy of the officers of the Los Angeles Trust and Savings Bank to confine their system to territory regarded as tributary to Los Angeles and not to undertake to create a statewide system of branches. Fresno is somewhat nearer to San Francisco than to Los Angeles but it has important commercial relations with both cities. It is the largest city in the San Joaquin Valley and the center of the raisin packing and has other important producing industries. The Bank of Italy has maintained a branch there for several years and has recently acquired the First National Bank also.

The Sacramento-San Joaquin Bank, also shown on the map, has its principal office in Sacramento and confines its operations to a limited portion of the area of the rich Sacramento and San Joaquin valleys. Other examples may be found of banks in interior cities with branches in the adjacent towns. Usually only a few branches are maintained, as for instance the Valley Bank of Fresno has branches in two nearby towns.

Arguments for branch banking.—The factors which have brought about the system of metropolitan branch banking in California have already been analyzed. Similar development is found in other states, notably New York. In the growth of "zone banking" California has had a unique development. It is in this field especially, therefore, that the California experience is of greatest interest.

Among the economic causes which have had a part in the success of branch banking is the ability of branch banks to make larger loans than can purely local banks. The producers of

¹ *Bulletin of the California Bankers' Association*, May, 1922, p. 1597.

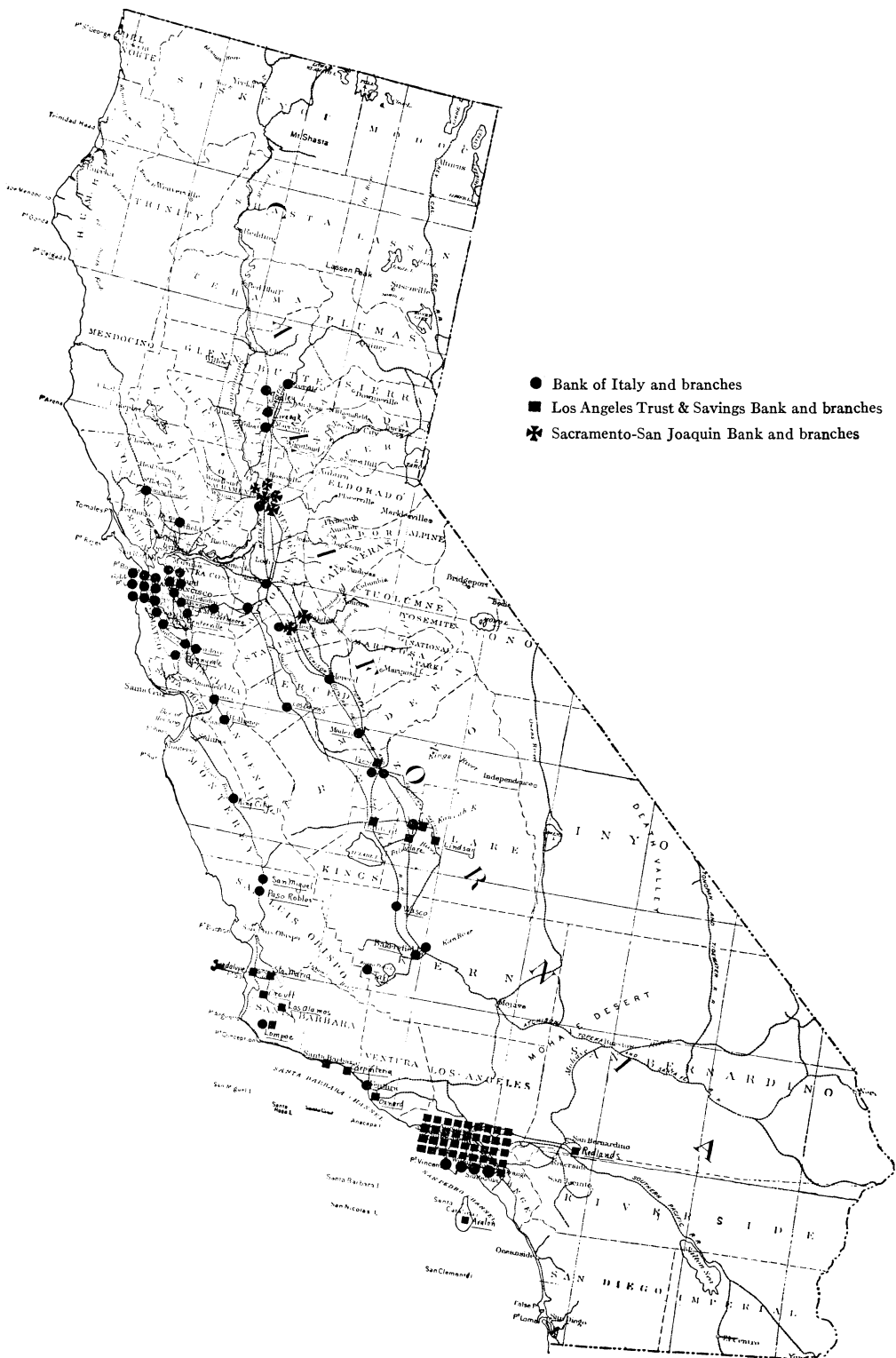


FIG. 1.—Map of California showing larger systems of branch banks. (Prepared by the Federal Reserve Bank of San Francisco.) Data as of July 1, 1922.

California no longer market their own crops in small lots. Co-operative marketing has brought together the producers in large economic units. This means that the size of a single loan required in fruit-growing sections is too great for the country bank to handle. In Fresno, e.g., a bank with \$1,000,000 capital and surplus would be regarded as a fairly large bank. But the law limits an individual loan by a bank of this capital to \$100,000. Fresno is the center of the raisin industry and has other important fruit-packing industries. The co-operative growers' associations have divided their banking business among the banks of the community, but even under these conditions the demand upon each bank far exceeds the loan limit of the ordinary local bank. The branches of the large systems which have extended into that section, on the other hand, may loan, upon proper security, any amount which the head office is allowed by law to loan to the same borrower. Under the branch system therefore borrowers in Fresno have direct connection with the largest banks of San Francisco and Los Angeles. The same condition prevails in other cities. The Bank of California, National Association, has capital and surplus of over \$17,000,000 which gives it a loan limit of over \$1,700,000. This great loaning power is a tremendous advantage to it in financing large grain shipments.

Moreover, there are seasonal demands which local banks are unable to take care of from their own resources. In the past they have called upon their city correspondents for assistance in carrying these loans. More recently the rediscount privileges of the Federal Reserve System have also been availed of for the same purpose. In this respect a branch system has some advantage in that it can shift funds from sluggish to active communities.

A further advantage which the advocates of branch banks have claimed for the system is the ability to offer more favorable interest rates to borrowers. The general tendency in rural communities is to keep the rate of interest fixed at a point which is almost invariable regardless of conditions in the general money market. Fluctuations in interest rates and differences in rates

upon different classes of paper are uncommon. When a city bank acquires a branch in a rural town or city it conforms its loaning policy in general to that in use in the main office. In some communities in California the immediate effect of the establishment of a branch has been to reduce interest rates for the better class of loans. Whether or not this has been solely to attract new business and will be discontinued when the business has been built up cannot now be predicted.

A branch bank also has certain advantages in the assembling and interpreting of credit information. The responsibility for the loaning policy is centralized in the hands of a few men who are expert bankers. Small country banks cannot secure the information that is available in large institutions. Frequently its officers are not skilled in analyzing a borrower's statement. Under the branch system local managers must of necessity be allowed a large amount of discretion in the making of loans. But these men are either carefully trained at the main office before being trusted with this responsibility or they are men of tested banking experience who were retained when the parent bank took over an institution that was already established.

It is believed by some students that better credit control is possible in time of stress through a system of branch banking. Professor J. F. Johnson has pointed out that the unity of the Canadian system enabled the banks to better prepare for the crisis of 1907. In Canada there was a gradual contraction of loans after June 1 and no panic was felt in the fall although conditions there and in the United States were substantially the same.¹ Professor E. R. A. Seligman, at the last meeting of the American Economic Association expressed the opinion that credit inflation when nearing the crest of a boom period can best be controlled by the substitution of branch banking for the present competitive conditions among the thirty thousand American banks.² The Federal Reserve System has demon-

¹ Joseph French Johnson, *The Canadian Banking System*. Publications of the National Monetary Commission, Senate Document No. 385, 61st Congress, Second Session.

² *American Economic Review*, XII (March, 1922), No. 1, 24.

strated its ability to meet a more serious situation than confronted the banks in 1907. It is believed that panic control has thus been attained but this does not mean that periods of stress will not be experienced. California's branch system is not sufficiently universal to form the basis for any valid conclusion upon this point. During the past two years only two state banks have closed and one of these has been reopened upon an entirely solvent basis but favorable economic conditions rather than branch banking appear to account for this splendid record.

The advocates of branch banking hold that the depositor is better protected by a branch system. Adverse local conditions which might wreck a single bank would not cause the failure of the entire system. It is unquestionably true that many bank failures are of small banks and would be prevented by a branch system. It is also true that should a failure occur in a branch system the consequences would be more serious and far-reaching. Internal examinations are essential in a branch system and ably supplement the scrutiny of the public supervisorial authority. Burglary and hold-ups are less likely to occur at a branch, since surplus cash and all bond investments are held in the vaults of the head office.

Objections to branch banking.—The question of personnel is crucial in any branch banking system. At this point American experience has little to offer as yet and conditions here are so unlike those in foreign systems that we cannot safely draw conclusions from elsewhere. The young man who enters the service of a bank in England or Canada expects to go wherever he may be sent in the line of service. The assistant manager of an American branch of a Canadian bank informed the writer that he has already served in half-a-dozen different branches in his progress to his present position. No such tradition has been built upon among American bank employees.

Officers of the Bank of California testify that they have experienced considerable difficulty in getting men in the San Francisco bank to accept appointments in the northern branches, even when the salary was enough higher to warrant the change. The banks operating branches throughout California do not

appear to have found any difficulty in taking care of the situation up to the present time. Many of the local branches are manned by the staff already in charge when the institutions were taken over but no difficulty has been experienced when it has been necessary to transfer men from the larger offices to manage local banks. The test will come when the management must be recruited from men who have not proved their fitness by the successful conduct of independent banks. The supporters of branch banking hold that a branch system offers the ambitious young man superior training and opportunity for advancement. They anticipate, therefore, that better bank management will result from the spread of branch banking.

One of the strongest popular objections to branch banking is the fear of concentration of financial resources. Larger banking units are inevitable under a branch system but it does not follow that monopoly of banking will result. Canada has not experienced this condition and there is no indication of a banking monopoly in California. At present stock in the larger branch systems is widely distributed. The stockholders in local banks have been encouraged to exchange their stock for stock in the larger system. On the other hand it is probably true that local stockholders have little actual direction of the bank's affairs, since their holdings, even if large in the bank which was absorbed, constitute a small minority in the large branch system. Moreover, it appears likely that the amount of locally owned stock will decrease as time passes.

This fear of centralized control of banking resources has been increased in California by the possibility of indirectly combining banking with other industrial and commercial enterprises. Several of the larger banks with branches have organized subsidiary corporations which are owned by the same stockholders. Since these corporations are not chartered under the Bank Act they have wider latitude in the range of business activities which they may carry on. One of the larger banks earlier engaged in the insurance business by means of its auxiliary corporation. This action met outside opposition and has been discontinued. The present tendency, therefore, appears to be to confine the

activities of the subsidiary organization to facilitating strictly banking functions. They may be used to assist in the acquisition of additional branches, to hold real estate, to take over doubtful assets thus enabling the bank to charge off the same, and to operate the bond and investment department of the bank. The possibility of creating such a corporation is not confined to a bank with branches and it is not essential to branch banking. The connection between the two, however, has contributed to the opposition to branch banks on the ground that it will inevitably result in financial concentration.

Branch banking encounters strong opposition based upon local pride and sentiment. The American system of unit banks with close personal interest in local development and an intimate personal feeling between banker and client have doubtless been powerful factors in the development of the United States. The fear that this will be lost through a branch system and the needs of the community sacrificed in order to meet the demands of enterprises fostered by the main bank is deep-seated. The local banker is a permanent resident in the community in contrast to the branch manager who may stay only a few months or years.

The psychology of this situation is important. Local prejudice has been used in California against the branch banks. This prejudice appears, however, to be based more upon sentiment than upon actual conditions. Frequently the management of a locally owned bank is allowed to stagnate. The young branch manager knows that his personal advancement depends upon his success in securing the good will of his community. One of the best ways to do this is to impress upon the people of the community, where he is located, that the bank is looking out for their interests. Where the former management is retained the strength of the "home bank" argument is largely lost. The latter arrangement has been so largely the method used in California mergers that the conditions there do not yet afford a test of this contention. Even where an outside representative is sent in as branch manager, there are still a large group of local stockholders, a local advisory committee, and many local employees.

Closely connected with this argument is the contention that funds will be drained from the country to the city. In Canada the banks have shifted money from the older eastern communities to the western provinces where higher interest rates prevail. In California there is no marked tendency in either direction. Country banks in the United States have learned the possibilities of buying commercial paper and utilize this outlet for all of their loanable funds. They also look to city correspondents and the Federal Reserve banks to assist in meeting seasonal local demands. Some banks are almost constantly owners of large amounts of outside paper and bond investments. Others find it necessary to rediscount rather frequently. The same conditions prevail in the branch systems of California. Some branches usually have more deposits than local loans; others are constantly debtor to the head office. In still others there are seasonal shiftings. If anything the branch system appears to have facilitated the placing of funds where the most active demand exists.

Branch banking has inevitably tended to disrupt existing correspondent relations between banks. Usually the bank which is absorbed into a branch system has not been a correspondent of the bank of which it becomes a part. In so far as the city banks have specialized in country bank accounts they will lose part of their business, unless they, too, establish branches. Country banks in the producing sections have usually maintained correspondent relations with banks in San Francisco, Los Angeles, and often in Eastern cities. It is possible that the change in correspondent arrangements will work adversely in the matter of securing funds to meet seasonal demands. In any event it raises the question of how the city bank, without branches or country correspondents, can participate in the necessary and profitable financing of the fruit production of the state.

The bankers' organizations have generally opposed branch banking. In 1916 the American Bankers' Association voted upon and rejected a resolution supporting branches of national banks. In the 1921 convention the National Bank Division passed a resolution asking Congress to place them on a basis of approximate equality with state banks in this matter. This was

simply in the interest of justice and not an expression upon branch banking as such. In fact some supporters of the resolution stated that they were opposed to the principle of branch banking. The State Bank Division, at the same meeting, adopted a resolution opposing branch banking of any kind.¹ This view, however, is by no means unanimous among bankers. The numerical strength of the opposition is easily explained since there are now about 30,000 unit banks in the United States.

Summary.—This investigation into branch banking shows that national banks in some states are unfairly handicapped by their inability to establish branches. The law should be amended and all uncertainty as to their right to establish branches cleared up. Since an indirect method already exists for them to get branches a direct method should be provided. Branch banking has spread in the United States during the past decade although several states meantime have taken action prohibiting any further branches. In many states branch banking is limited to a single community. The primary reason for this development is the convenience of patrons. The possibilities of this type of branch banking are very limited and little objection is raised against it.

California banks are making the experiment with branch banking over a wider geographical area. The development is too recent to afford a basis for final conclusions. It has proved successful where tried and is spreading throughout the state. It appears probable that there will be a still further development of branch banking in the United States. For this reason the experience of California banks will be watched with unusual interest.

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¹ *Journal of the American Bankers' Association*, November, 1921, pp. 405, 419, 421.